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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. ~~880~~ 16

GROUP OF INSTITUTIONAL INVESTORS, and MUTUAL SAVINGS BANK GROUP,
Petitioners,

vs.

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY, *et al.*,
Respondents.

BRIEF OF CHICAGO, TERRE HAUTE AND SOUTHEASTERN RAILWAY COMPANY AND OTHERS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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(For Names of Other Respondents See Inside Cover)

March 23, 1942

THE TWENTIETH CENTURY PRESS, INC., CHICAGO

Respondents (Continued)

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IN THE

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No. 880

GROUP OF INSTITUTIONAL INVESTORS, and MUTUAL SAVINGS BANK GROUP,

Petitioners,

vs.

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD COMPANY, *et al.*,

Respondents.

BRIEF OF CHICAGO, TERRE HAUTE AND SOUTHEASTERN RAILWAY COMPANY AND OTHERS IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

This brief is submitted in behalf of the respondents here who were appellants in the United States Circuit Court of Appeals for the Seventh Circuit in Cause No. 7614 in that court, entitled "*In the Matter of Chicago, Milwaukee, St. Paul & Pacific Railroad Company, Debtor; Chicago, Terre Haute & Southeastern Ry. Co., Income Mortgage Bondholders' Committee, et al., Appellants vs. Group of Institutional Investors, etc., et al., Appellees*" (R. 2321-2322).

OPINIONS BELOW

The reports and orders of the Interstate Commerce Commission are reported in 239 I. C. C. 485 and 240 I. C. C. 257 (Original Report, R. 2153-2269, and Order, R. 1258-1283; Supplemental Report, R. 1284-1317, and Order, R. 1319-1347). The opinion of the District Court is reported in 36 F. Supp. 193 (R. 1857-1899). The opinion of the Circuit Court of Appeals is reported in 124 F. (2d) 754 (R. 2297-2317, 2334-2335).

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on December 4, 1941 (R. 2318, 2321-2322). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. C. A. § 347).

STATEMENT OF THE CASE

We are content with petitioners' statement except with respect to the facts pertinent to certain issues which arise in connection with a lease to the debtor of the railroad properties of the Chicago, Terre Haute and Southeastern Railway Company (hereinafter referred to as the "Terre Haute"), respondent herein.

The Terre Haute is a railroad corporation separate and distinct from the debtor (R. 1512). It is not in bankruptcy or receivership in any state or federal court (R. 1876, 2158). The other respondents joining in this brief are two owners of Terre Haute bonds (R. 1439), two protective committees for holders of Terre Haute bonds (R. 1373, 1477), and the trustees under the four mortgages securing Terre Haute bonds (R. 1414, 1434, 1465, 1480).

On July 1, 1921, the Terre Haute leased its railroad properties to the debtor's predecessor, the Chicago, Milwaukee and St. Paul Railway Company, for a term of 999 years (R. 2163). The debtor acquired the assets of its predecessor in the 1928 reorganization of that company, and in connection therewith adopted the Terre Haute lease (R. 2162-2163). Under the terms of the lease, the lessee is obligated to operate the Terre Haute and pay all expenses incident thereto, to pay an amount equal to the interest on the bonds of the Terre Haute (amounting to $1,023,580 annually (R. 2169)), the principal of such bonds at maturity, the expense of maintaining the Terre Haute's corporate existence (not in excess of $12,000 a year), and all taxes, and to perform the covenants of the Terre Haute

bonds and mortgages and maintain and replace the Terre Haute equipment.[1]

The debtor's trustees have not elected either to adopt or reject the lease (R. 1510), but have continued to hold and operate the Terre Haute properties, orders entered by the District Court having from time to time extended the time within which such election might be made (R. 46, 84, 91, 121, 144, 164, 197, 198, 210, 232, 1351), and having enjoined any interference with the possession of the debtor or its trustees (R. 48, 80). The trustees have paid the current interest on the Terre Haute bonds (R. 2169), but have not performed the provisions of the lease requiring

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[1] The lease was introduced in evidence before the Interstate Commerce Commission as Debtor's Exhibit 63 (R. 283). Such exhibits, and the exhibits introduced in evidence before the District Court, are a part of the record, but are not included in the printed transcript.

The maturities and interest rates of the Terre Haute bonds are as follows (R. 2169-2170):

Bedford Belt Railway Company First Mortgage 5% bonds, due July 1, 1938, $250,000.

Southern Indiana Railway Company First Mortgage 4% bonds, due February 1, 1951, $7,287,000.

Chicago, Terre Haute and Southeastern Railway Company First and Refunding Mortgage 5% bonds, due December 1, 1960, $8,056,000.

Chicago, Terre Haute and Southeastern Railway Company 5% Income Mortgage bonds, due December 1, 1960, $6,336,000.

Upon termination of the lease the Terre Haute is required to repay the amount of principal payments made by the lessee, but such repayment may be made in bonds of the Terre Haute at par.

replacement of Terre Haute equipment and payment of bond principal at maturity[2] (R. 193, 2170).

The reorganization plan proposes extensive modifications of the Terre Haute bonds and mortgages and the making of a new lease upon terms more favorable to the lessee.[3] After confirmation of the plan by the District Court the proposed modifications of the Terre Haute bonds and mortgages and the proposed new lease are to be submitted to the Terre Haute bondholders for acceptance or rejection. If the court thereafter determines that the proposals have not been accepted by substantially all of those bondholders the present lease is to be rejected "as of the date of such determination by the court" (R. 1330-1331).

In the Circuit Court of Appeals these respondents sought reversal of the order of the District Court approving the plan on the following grounds, among others (R. 2025, 2030-2032):

1. That it was error to provide in the plan for rejection of the lease, for the reason that it is profitable, not burdensome, to the lessee.

2. That if the lease is to be rejected, it was error to provide in the plan that the rejection should take

---

[2] The Bedford Belt bonds, which matured July 1, 1938, have not been paid (R. 193).

[3] The proposal consists, *inter alia*, of extension of all Terre Haute bond maturities to July 1, 1989; reduction of bond interest to 2¾% per annum fixed and 1½% per annum contingent (the contingent interest being payable on the basis of system income only after payment of all fixed charges of the reorganized company and apportionment of $2,500,000 annually for capital expenditures); waiver of all equipment vacancies to July 1, 1939, and modification of the covenants relating to replacement of equipment retired in the future (R. 1330-1331).

effect as of a future date, rather than as of the date on which the reorganization proceeding was instituted."

The judgment of the Circuit Court of Appeals reversed the order of the District Court and directed that the case be remanded to the Interstate Commerce Commission for the making of findings, and, if necessary, the taking of additional evidence, that additional findings might be made (R. 2321-2322).

The representatives of the Terre Haute First Mortgage bondholders have urged throughout the case, as an additional reason for disapproval of the plan, that it violated the rule announced by this Court in *Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106, and *Consolidated Rock Co.* v. *Du Bois*, 312 U. S. 510, in that it provided substantially the same treatment for the junior Income Mortgage Bonds of the Terre Haute as for the Terre Haute First Mortgage Bonds, thereby failing to accord to the prior lien bondholders the preferred treatment to which their superior liens entitle them. The Income Mortgage bondholders have never conceded that such treatment of the Terre Haute bonds would violate the rule of those cases under the circumstances here involved. The Circuit Court of Appeals held, as to the plan's disposition of the Terre Haute bond issues, that "it is quite impossible to approve the disposition of the Terre Haute bond issues without having more specific findings" (R. 2314).

It would not appear to be necessary for the Court to consider this question at the present stage of the proceeding, and this statement is included here only to make it clear that neither party waives the point in any future proceedings.

QUESTIONS PRESENTED

1. What findings by the Interstate Commerce Commission are necessary to enable the court to determine whether a railroad lease can be rejected as part of a plan of reorganization of a lessee railroad under section 77; and did the Commission make them in this case?

2. What findings are necessary to enable the court to determine whether the rejection of a railroad lease may take effect as of some future date instead of relating back to the commencement of the reorganization proceeding; and did the Commission make them in this case?

SUMMARY OF ARGUMENT

I

A plan of reorganization of a lessee railroad may provide for rejection of the lease only if it be burdensome. The Commission did not find that the Terre Haute lease is or will be burdensome to the lessee.

II

It is well established that in the event of rejection of a railroad lease the rejection must take effect as of the date on which the reorganization proceeding was instituted. The Commission did not find any facts which would give rise to special equities sufficient to prevent the operation of this general rule in the instant case.

ARGUMENT

I

A PLAN OF REORGANIZATION OF A LESSEE RAILROAD MAY PROVIDE FOR REJECTION OF THE LEASE ONLY IF IT BE BURDENSOME. THE COMMISSION DID NOT FIND THAT THE TERRE HAUTE LEASE IS OR WILL BE BURDENSOME TO THE LESSEE.

The statutory authority to reject leases in section 77 proceedings is found in the following provisions (11 U. S. C. A. § 205):

"(b) A plan of reorganization within the meaning of this section * * * may reject contracts of the debtor which are executory in whole or in part, including unexpired leases; and may include any other appropriate provisions not inconsistent with this section.

"The adoption of an executory contract or unexpired lease by the trustee or trustees of a debtor shall not preclude a rejection of such contract or lease in a plan of reorganization approved hereunder, and any claim resulting from such rejection shall not have priority over any other claims against the debtor because such contract or lease had been previously adopted.

* * *

"(c) After approving the petition:

* * *

"(2) The Judge shall fix the amount of the bond of every trustee. * * * The trustee or trustees so appointed, upon filing such bond, shall have all the title and shall exercise, subject to the control of the judge and consistently with the provisions of this section, all of the powers of a trustee appointed pursuant to section 44 of this Act or any other section of this Act,

and, to the extent not inconsistent with this section, if authorized by the judge, the powers of a receiver in an equity proceeding, and, subject to the control of the judge and the jurisdiction of the Commission as provided by the Interstate Commerce Act as now or hereafter amended, the power to operate the business of the debtor."

It is well settled in equity receiverships that only burdensome leases may be rejected. *American Brake Shoe & F. Co.* v. *New York Rys. Co.*, 278 Fed. 842, 843 (S. D. N. Y. 1922); *Butterworth* v. *Degnon Contracting Co.*, 214 Fed. 772, 773 (C. C. A. 2, 1914). In the last case cited the court said (p. 773):

> "* * * On taking possession as receiver he found a contract which might develop into an exceedingly valuable asset. Had he repudiated it, without investigation, he would have been guilty of a clear dereliction of duty. He was in duty bound to proceed with the contract if it were beneficial to the estate administered by him and to abandon it if not beneficial."

The same test is clearly applicable in proceedings under section 77. In *Palmer* v. *Webster & Atlas Bank*, 312 U. S. 156, this Court said (p. 163):

> "* * * Section 77 (c) (2) accords the trustees of a railroad in reorganization the right to reject *burdensome* leases." (Italics ours.)

See also *Philadelphia Co.* v. *Dipple*, 312 U. S. 168, at page 174.

This being the rule, the Circuit Court of Appeals was correct in reversing the District Court's approval of the plan, since the record shows that the Commission's decision to reject the Terre Haute lease was based not upon a determination that the lease is or will be burdensome to the lessee, but upon the thought that if the Milwaukee bondholders are to have their bonds and interest reduced, the

Terre Haute bondholders should do likewise—apparently because the Terre Haute is being operated as part of the "Milwaukee family" and is so much smaller than the Milwaukee. Thus in its Original Report (R. 2214-2218) the Commission said that the capital structure of the reorganized company should not be too heavily weighted by Terre Haute obligations and declared that it would approve

> "* * * provisions for dealing with the Terre Haute bonds in a manner which bears a fair and equitable relationship to the treatment accorded the bondholders of the debtor * * *" (R. 2216).

Elsewhere it concluded that if the Terre Haute mortgages and lease were allowed to stand without change the fixed charges on the Terre Haute obligations would be out of proportion with the portion of the system mileage and physical value on which such obligations constitute a lien (R. 2214-2216). *However, nowhere does the Commission find that the lease as it stands is or would be burdensome to the Milwaukee system. In fact it found that the earning power of the Terre Haute is sufficient to cover its interest requirements* (R. 2213), and referred to the earnings of the Terre Haute available for interest, which for the year 1936 amounted to $2,990,126 (on the basis of allowing the Terre Haute tariff rates on coal and other company material hauled for the Milwaukee) (R. 2212), as compared with interest requirements of $1,023,580 on the Terre Haute bonds (R. 2169). The Commission pointed out that the year 1936 was not an unusually favorable period (R. 2213) and also pointed out that the Terre Haute should be retained as a part of the Milwaukee system, saying, in its Supplemental Report (R. 1302-1303):

> "We concluded that the desirable consolidation of the Terre Haute lines with those of the Debtor, and the exchange of new system bonds for the existing Terre Haute bonds, were impracticable in connection

with the plan because of the legal obstacle lying in the fact of the Terre Haute's outside status. Despite this fact the Terre Haute is in practical effect a part of the Milwaukee system, its bondholders are essentially system creditors, and a disruption of the lines would be to the disadvantage of both companies. We have been and remain strongly of the opinion that the plan should provide some means for retaining the Terre Haute lines as a part of the system without unduly jeopardizing a successful reorganization of the Milwaukee."

The only comment which might possibly be construed as a suggestion that the lease might be a burden in the sense of being unprofitable, is the Commission's statement, quoted in the brief of the petitioners at page 39, to the effect that the earning power is largely dependent upon a continuation of the Milwaukee coal traffic and would be greatly diminished if such traffic ceased. The suggestion that the Milwaukee's coal traffic might be withdrawn from the Terre Haute is mere speculation as to the future and contrary to any possible interpretation of the evidence—the Milwaukee holding 97% of the Terre Haute stock (R. 1876)—and does not constitute a finding that the present lease is burdensome. If the Commission found anything it was that although the Milwaukee system is profiting from the lease of the Terre Haute, it should profit still more. Respondents submit that such a finding is insufficient as a matter of law to justify rejection of the lease. The Circuit Court of Appeals was correct in reversing the District Court and directing it to remand the plan to the Commission for specific findings, viz., as to whether the lease is or will be burdensome to the lessee.

At page 41 of petitioners' brief in support of their petition it is stated that the Commission held that "the terms of the present lease were too burdensome to permit their assumption by the reorganized company." This is an un-

warranted twisting of the Commission's statements. The Commission nowhere found that the lease is or will be burdensome to the lessee, and therefore could not be assumed. It said that, even though the Terre Haute was earning its interest requirements, it would not be equitable for the Terre Haute bondholders to keep their present interest rates when the Milwaukee bondholders had to reduce theirs, a matter which has nothing to do with the question whether the lease is or will be burdensome to the Milwaukee.

The Commission indicated that it had an absolute right to require rejection of the lease, regardless of whether it was burdensome or profitable (R. 1302), and the District Court apparently concurred (R. 1882).

We have contended that the right of rejection exists only if the lease be burdensome. In this the Circuit Court of Appeals apparently upheld us—since it held that findings of fact as to the lease were necessary before the court could decide whether the lease could be rejected (R. 2314).

The Commission's failure to make any finding as to whether the lease is or will be burdensome to the lessee clearly required such a holding.

II

THE INTERSTATE COMMERCE COMMISSION DID NOT MAKE FINDINGS SUFFICIENT TO SUPPORT THE PROVISION OF THE PLAN THAT REJECTION OF THE LEASE SHALL TAKE EFFECT AS OF A FUTURE DATE RATHER THAN AS OF THE DATE ON WHICH THE PROCEEDING WAS INSTITUTED.

The plan provides that the Terre Haute lease shall be rejected as of the date, subsequent to confirmation, on which the court determines that the Terre Haute bondholders

have refused to agree to the proposed modifications of their bonds and mortgages which the plan demands and to the proposed new lease (R. 1330-1331). This violates the established rule that rejection of a railroad lease in reorganization takes effect as of the date of the institution of the proceeding, that damages for the breach are measured as of that date, and that the operation of the leased line after that date is for the account of the lessor, which is chargeable with all losses and entitled to any profits. The Circuit Court of Appeals did not discuss this issue in its opinion, although the question was earnestly and fully presented to it. The plan's clear violation of law in this respect, however, fully supports the judgment below reversing the District Court's order of approval.[4]

The principle upon which we rely—that rejection must take effect as of the date on which the proceeding was instituted—is indisputable.

In *Connecticut Ry. Co.* v. *Palmer*, 305 U. S. 493, 502, 504-505, this Court held that subdivision (b) of section 77 requires a lessor's claim for damages, in the event of rejection, to be determined in accordance with the principles

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[4] This brief assumes that the judgment of the Circuit Court of Appeals (R. 2321-2322) upholds the general rule that rejection relates back to the beginning of the proceeding and directs the making of findings on the question whether there are present facts giving rise to special equities which might create an estoppel against application of the rule here. A possible—though we believe erroneous—construction of the judgment is that it rejects the general rule by implication. Because of that possibility, these respondents have heretofore filed, in No. 1004, their petition for a writ of certiorari to review the judgment if so construed.

applicable in equity proceedings to executory contracts. The pertinent portion of section 77 (b) is as follows (11 U. S. C. A. § 205 (b)):

> "In case an executory contract or unexpired lease of property shall be rejected, or shall not have been adopted by a trustee appointed under this section, or shall have been rejected by a receiver in equity in a proceeding pending prior to the institution of a proceeding under this section, or shall be rejected by any plan, any person injured by such nonadoption or rejection shall for all purposes of this section be deemed to be a creditor of the debtor to the extent of the actual damage or injury determined in accordance with principles obtaining in equity proceedings."

In equity proceedings it is well established that in the event of rejection of an executory contract the claim for damages must be measured as of the beginning of the proceeding. *Samuels* v. *E. F. Drew & Co.*, 292 Fed. 734, 736-738; *Pennsylvania Steel Co.* v. *New York City Ry. Co.*, 198 Fed. 721, 735, 744. Accordingly, in section 77 proceedings rejection of a lease must take effect as of the beginning of the proceeding and the lessor's claim for damages must be measured as of that date. *In re New York, N. H. & H. R. Co.*, 30 F. Supp. 541, 543.

Similarly, in the event of rejection of a railroad lease, the operation of the leased line by the lessor's receiver or trustee is held to have been for the account of the lessor from the beginning of the proceeding, and the lessor is chargeable with all losses and is entitled to any profits. This is the rule in equity (*Pennsylvania Steel Co.* v. *New York City Ry. Co.*, 198 Fed. 721, 729-731; *Westinghouse Electric & Mfg. Co.* v. *Brooklyn Rapid T. Co.*, 6 F. (2d) 547, 549-550; *American Brake Shoe & Foundry Co.* v. *New York Rys. Co.*, 282 Fed. 523, 529; *Mercantile Trust Co.* v. *Farmers' Loan & Trust Co.*, 81 Fed. 254, 258), and its appli-

cability to section 77 proceedings is recognized by subdivision (c) (6) of the statute, by the decision of this Court in *Palmer* v. *Webster & Atlas Bank*, 312 U. S. 156, by the decision of the Circuit Court of Appeals for the Second Circuit in *Palmer* v. *Palmer*, 104 F. (2d) 161, and by a dictum in the opinion of the Circuit Court of Appeals for the Seventh Circuit in *In re Chicago, R. I. & P. Ry. Co.*, 110 F. (2d) 395, 399.

Thus section 77 (c) (6) provides (11 U. S. C. A. § 205 (c) (6)):

> "If a lease of a line of railroad is rejected, and if the lessee, with the approval of the judge, shall elect no longer to operate the leased line, it shall be the duty of the lessor at the end of a period to be fixed by the judge to begin the operation of such line, unless the judge, upon the petition of the lessor, shall decree after hearing that it would be impracticable and contrary to the public interest for the lessor to operate the said line, in which event it shall be the duty of the lessee *to continue* operation on or for the account of the lessor until the abandonment of such line is authorized by the Commission in accordance with the provisions of section 1 of the Interstate Commerce Act as amended." (Italics ours.)

In *Palmer* v. *Webster & Atlas Bank*, 312 U. S. 156, this Court upheld as the exercise of a sound discretion action of a district court which it recognized (312 U. S. at page 162) had been based in part upon application of the principle that rejection relates back to the date of the debtor's petition and that after that date operation is for the account of the lessor. In *Palmer* v. *Palmer*, 104 F. (2d) 161, the same principle was squarely upheld.

It is stated in some of the decisions that the facts of a particular case may give rise to special equities sufficient to prevent operation of the general rule. See *Pennsylvania Steel Co.* v. *New York City Ry. Co.*, 198 Fed. 721, 730;

Palmer v. *Palmer*, 104 F. (2d) 161, 164. In the instant case the record contains no evidence of any such facts and the Interstate Commerce Commission has made no findings with respect thereto. The complete absence of such findings clearly prevented approval of the plan, for in the absence of special equities the provision of the plan that the rejection should take effect as of a future date would constitute an unquestionable violation of the general rule. The Circuit Court of Appeals was therefore correct in reversing the district court's order approving the plan and in directing it to remand the case to the Interstate Commerce Commission for findings.

CONCLUSION

If the petition for a writ of certiorari should be granted, we respectfully request that this Court affirm the judgment of the Circuit Court of Appeals, but that in doing so it instruct the courts below and the Commission that the Terre Haute lease may not be rejected in the absence of findings that it is or will be burdensome to the lessee, and that rejection, if it occurs, must take effect as of the date on which the debtor's reorganization proceeding was instituted in the absence of findings of facts giving rise to special equities sufficient to prevent operation of the general rule of relation back.

Respectfully submitted,

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APPENDIX.

The provisions of section 77 of the Bankruptcy Act (11 U. S. C. A. § 205) most pertinent to the issues dealt with herein are the following:

"(b) A plan of reorganization within the meaning of this section * * * may reject contracts of the debtor which are executory in whole or in part, including unexpired leases; and may include any other appropriate provisions not inconsistent with this section.

"The adoption of an executory contract or unexpired lease by the trustee or trustees of a debtor shall not preclude a rejection of such contract or lease in a plan of reorganization approved hereunder, and any claim resulting from such rejection shall not have priority over any other claims against the debtor because such contract or lease had been previously adopted. * * * The term 'creditors' shall include, for all purposes of this section all holders of claims of whatever character against the debtor or its property, whether or not such claims would otherwise constitute provable claims under this Act, including the holder of a claim under a contract executory in whole or in part including an unexpired lease.

"* * * In case an executory contract or unexpired lease of property shall be rejected, or shall not have been adopted by a trustee appointed under this section, or shall have been rejected by a receiver in equity in a proceeding pending prior to the institution of a proceeding under this section, or shall be rejected by any plan, any person injured by such nonadoption or rejection shall for all purposes of this section be deemed to be a creditor of the debtor to the extent of the actual damage or injury determined in accordance with principles obtaining in equity proceedings. * * *

"(c) After approving the petition:

• • •

"(2) The judge shall fix the amount of the bond of every trustee. • • • The trustee or trustees so appointed, upon filing such bond, shall have all the title and shall exercise, subject to the control of the judge and consistently with the provisions of this section, all of the powers of a trustee appointed pursuant to section 44 of this Act or any other section of this Act, and, to the extent not inconsistent with this section, if authorized by the judge, the powers of a receiver in an equity proceeding, and, subject to the control of the judge and the jurisdiction of the Commission as provided by the Interstate Commerce Act as now or hereafter amended, the power to operate the business of the debtor.

• • •

"(6) If a lease of a line of railroad is rejected, and if the lessee, with the approval of the judge, shall elect no longer to operate the leased line, it shall be the duty of the lessor at the end of a period to be fixed by the judge to begin the operation of such line, unless the judge, upon the petition of the lessor, shall decree after hearing that it would be impracticable and contrary to the public interest for the lessor to operate the said line, in which event it shall be the duty of the lessee to continue operation on or for the account of the lessor until the abandonment of such line is authorized by the Commission in accordance with the provisions of section 1 of the Interstate Commerce Act as amended."